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Cases, Regulations and Statutes

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"Indicia of ownership that are held primarily to protect a security interest include legal or equitable title acquired through or incident to foreclosure and its equivalents."[22]

The rule then pointed out that —

"The indicia of ownership held after foreclosure continue to be maintained primarily as protection for a security interest provided that the holder undertakes to sell, re-lease the property...or otherwise divest itself of the property in a reasonably expeditious manner...."[23]

Neither CERCLA nor the EPA rule require a prospective mortgagee to conduct an environmental audit at the site to qualify for the "lender exemption." Thus it is clear that —

• A lender remains within the exemption during the term of the security interest even though action is taken to police the loan.

• The exemption can be maintained even in the event of foreclosure provided the lender undertakes to sell or otherwise divest itself of the property in a reasonably expeditious manner using normal commercial means provided the mortgagee did not participate in management prior to the foreclosure.

• Following foreclosure, while the mortgagee is holding the property for disposition, the lender may liquidate, maintain business activities, wind up operations or perform environmental clean-up operations.

EPA rule held invalid

In a major development in 1994, much to the surprise of lenders, the EPA rule was invalidated in *Kelley v. EPA*.[24] The U.S. Supreme Court refused to review the *Kelley* case in January of 1995. The lending community responded with renewed efforts to lobby for Congressional relief.[25] The lender liability provisions of that legislation would have differed from the EPA rule in two major respects — (1) lenders would be required to perform pre-loan due diligence as a precondition to receiving favored treatment, and (2) qualifying lenders would still be liable for the net gains realized, if any, as a result of clean-up activities by EPA. The legislation did not pass in 1994. Legislation has been introduced in 1995 and is pending in the 104th Congress.[26] That legislation would adopt many of the provisions in the EPA rule statutorily.

FOOTNOTES

1 42 U.S.C. § 9607 et seq. (1988).

2 See, e.g., United States v. Mirabile, 15 Env. L. Rep. 20994 (E.D. Pa. 1985). See N. Harl, "Liability for Toxic Waste Clean-Up," 6 *Agric. L. Dig*. 65 (1995) (liability of bank as fiduciary).

3 42 U.S.C. § 9601-9657.

4 42 U.S.C. § 9601(2)(A)(ii).

5 *Id*.

6 15 Env. L. Rep. 20994 (E.D. Pa. 1985).

7 *Id*.

8 16 Env. L. Rep. 20557 (D. Md. 1986).

9 *Id*.

10 *Id*.

11 901 F.2d 1550 (11th Cir. 1990), *cert. denied*, 498 U.S. 1046 (1991).

12 901 F.2d 1550, 1557 (emphasis added).

13 901 F.2d 1550, 1558.

14 *Id*.

15 Note 11 *supra*.

16 Note 11 *supra*.

17 24 Env. L. 1045, 1046 (1994).

18 40 C.F.R. § 300.1100(c)(1) (1994).

19 See note 11 *supra*.

20 40 C.F.R. § 300.1100(c)(1) (1994).

21 *Id*.

22 40 C.F.R. § 300.1100(d)(1) (1994).

23 *Id*.

24 15 F.3d 1100, 1108 (D.C. Cir. 1994).

25 Superfund Reform Act of 1994, S. 1834, 103d Cong., 2d Sess. (1994).

26 H.R. 200, 104th Cong., 1st Sess. (1995).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

EXEMPTIONS

AVOIDABLE LIENS. The debtors were livestock and grain farmers who filed for Chapter 7 bankruptcy. The debtors had granted a pre-petition security interest to their parents in farm machinery and livestock. The debtors claimed exemptions in all farm equipment, livestock and farm produce under Minn. Stat. § 550.37(5) and sought to avoid the security interest in the machinery and livestock under Section 522(f)(2)(B) as impairing the debtors' exemption for those assets. The trustee objected to the exemptions and avoidance of the security interest, arguing that the trustee had the power to avoid the security interest as unperfected; therefore, the debtors could not claim an exemption for the property reclaimed by the trustee. The court held that because the debtors sought avoidance first, the trustee was barred from attempting to avoid the security interest. The court held that Section 522(f)(2)(B) did not apply to livestock or crops not used for the personal benefit of the debtors; therefore, the security interest could not be avoided as to those assets but could only be avoided as to the debtors' tools of the trade which included a long list of assets from a tractor to livestock huts. ***In re* Flitter, 181 B.R. 938 (Bankr. D. Minn. 1995)**.

The debtors claimed an exemption in a residence which was subject to a mortgage and a judicial lien in excess of the fair market value of the property. The debtors sought to avoid the judicial lien and the issue was whether the entire lien was avoidable or whether the lien was avoidable only to the extent of the debtors' exemption amount. The case was filed after the effective date of the 1994 amendment to Section 522(f) and the court held that the amendment codified the holding of *In re Brantz, 106 B.R. 62 (Bankr. E.D. Pa. 1989)* which held that the lien was avoidable only to the extent the lien impaired the exemption. ***In re* Thomsen, 181 B.R. 1013 (Bankr. M.D. Ga. 1995)**.

CHAPTER 12-*ALM* § 13.03[8].*

TRUSTEE FEE. The debtor's Chapter 12 plan provided for payment of the only three creditors, two governmental units and the FmHA (now CFSA). The plan provided for direct payments of the secured claims and payments of unsecured claims from disposable income through the trustee. The trustee objected to the direct payments. The court held that, because the creditors were sophisticated creditors, the debtor could make direct payments without payment of the trustee fee. **Matter of Cross, 182 B.R. 42 (Bankr. D. Neb. 1995)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

CLAIMS. The debtors had failed to make required payments to fund two defined benefit pension plans. The IRS filed a claim in the bankruptcy case for excise taxes, under I.R.C. § 4971, for the failure of the debtors to contribute the amounts to the benefit plans in 1989. After the claims bar date, the IRS submitted amended claims including additional penalties for 1989 and taxes and penalties for failure to make payments in 1990. The IRS sought priority status for the claims, administrative priority for the claims and allowance of the amended claims. The court held that the Section 4971 taxes were penalties and not excise taxes and were not entitled to priority as taxes or administrative expenses. The IRS amended claims were not allowed as untimely and as not sufficiently related to the original claims. ***In re* CF & I Fabricators of Utah, Inc., 53 F.3d 1155 (10th Cir. 1995), *aff'g unrep. D. Ct. dec. aff'g*, 148 B.R. 332 (Bankr. D. Utah 1992)**.

DISCHARGE. The debtors' income tax returns were audited and additional taxes and civil fraud penalties were assessed. After some negotiations, the debtor consented to reduced amounts of taxes and penalties. The IRS argued in the bankruptcy case that the debtors' consent to the penalties collaterally estopped the debtors from challenging the issue that the taxes were nondischargeable for fraud. The court held that the settlement agreement did not meet the requirements for collateral estoppel because no adjudication took place. ***In re* Stodut, 181 B.R. 751 (Bankr. S.D. N.Y. 1995)**.

The debtor failed to timely file tax returns for 1979 and 1980. After an investigation was started by the IRS, the debtor filed returns for those years but reported no tax liability. The IRS audit assessed taxes for both years and assessed a civil fraud penalty. The debtor made some payments on the assessments until filing for Chapter 7 bankruptcy in 1993. The IRS filed a motion for summary judgment, arguing that the assessment of the civil fraud penalty made the taxes nondischargeable as a matter of law. The court held that the mere assessment of civil fraud penalties was insufficient alone to make the taxes nondischargeable and denied the motion for summary judgment. ***In re* D'Alessio, 181 B.R. 756 (Bankr. S.D. N.Y. 1995)**.

The debtors timely filed their 1990 income tax return. In October 1993, the debtors filed a Chapter 13 case which was dismissed 169 days later. The IRS assessed the debtors for additional 1990 taxes more than 240 days before the current case was filed in May 1994, more than three years after the 1990 tax return was filed. The IRS argued that, under Section 108(c) and I.R.C. § 6503(h), the first bankruptcy case tolled the three year period of Sections 507(a)(7)(A)(i) and 523(a)(7)(B) such that the taxes were not dischargeable under those sections. The court held that the plain language of Section 108(c) and I.R.C. § 6503(h) indicates that those laws do not apply to bankruptcy provisions. The court noted a significant split in the cases on this issue. ***In re* Gore, 182 B.R. 293 (Bankr. N.D. Ala. 1995)**. See also ***In re* Turner, 182 B.R. 317 (Bankr. N.D. Ala. 1995) (same holding on similar facts)**.

The debtors failed to file federal income tax returns for eights years, although the debtors had filed for the previous year and had income during the years no return was filed. The court held that the taxes for those years were nondischargeable for willful attempt to evade payment of taxes. ***In re* Bruner, 95-2 U.S. Tax Cas. (CCH) ¶ 50356 (5th Cir. 1995)**.

DISMISSAL. The debtor had filed a previous Chapter 7 case in which a federal tax claim was held to be nondischargeable because of the debtor's willful failure to pay taxes. The IRS had a tax lien on the debtor's property and had levied against the debtor's only asset, monthly social security payments. The debtor filed for Chapter 13 when the eligibility requirements were increased and the IRS moved to dismiss the case and objected to the plan, both on the grounds of bad faith. The IRS argued that, because the tax debt was the only debt involved in the case and because the debt was nondischargeable, the filing of the Chapter 13 case was in bad faith. The court held that, under its holding in *In re Gathright, 67 B.R. 384 (Bankr. E.D. Pa. 1986), app. dismissed, 71 B.R. 343 (E.D. Pa. 1987)*, there is no good faith filing requirement for Chapter 13 cases. The court also held that only debtor misconduct or fraud in the bankruptcy proceeding can give rise to bad faith sufficient to deny confirmation of a plan or discharge in Chapter 13. Because the debtor had accurately filed all schedules and met all Chapter 13 requirements, confirmation could not be denied for bad faith. ***In re* Lilley, 181 B.R. 809 (Bankr. E.D. Pa. 1995)**.

PRIORITY. The debtor had filed a prior Chapter 11 case in which a plan was confirmed, but the debtor defaulted on the plan payments and filed a second Chapter 11 case. The IRS had filed a claim for taxes which had a priority under Section 507(a)(7). The issue was whether the unpaid portion of the tax claims was eligible for a priority in the second case or was only general unsecured claims based on the debtor's default of the plan payments. The court held that the tax claims retained their status as tax claims and were eligible for priority status if the claims otherwise met the priority requirements in the second case. ***In re* Conston, Inc., 181 B.R. 769 (D. Del. 1995)**.

TRUSTEE LIABILITY. The debtors filed for Chapter 11 and were appointed debtors-in-possession. The debtors sold estate property by installment sale under approval of the court. The debtors received the 1991 installment payment while debtors-in-possession. In 1992, a liquidating trustee was appointed and the trustee sought a ruling as to whether the estate was liable for the tax on the gain reportable from the first installment payment. The trustee alleged that the debtors had misappropriated the payment for their personal use. The court held that the trustee would be liable for payment of the taxes if the debtors (1) transferred the payment to the liquidating trustee, (2) used the payment to pay creditors, (3) used the payment in the operation of the business, or (4) used the payment to pay administrative expenses. The court found that the debtors had filed inaccurate 1991 tax returns; therefore, the court had insufficient evidence of the disposition of the payment to make a ruling. The court deferred a ruling until the debtors' 1991 tax returns were properly constructed by the trustee. ***In re* McRae, 181 B.R. 866 (Bankr. S.D. Tex. 1994)**.

CONTRACTS

BREACH. The plaintiff was a grain cooperative which had hired the defendant to manage the facility to help the cooperative make a profit. The defendant's management did achieve a profit for one year but the plaintiff soon after had to liquidate. The plaintiff sued for breach of the management contract under the theory of breach of an implied warranty to perform in a workmanlike manner. The defendant argued that the contract's "hold harmless" clause relieved it of any liability for any losses incurred during the contract. The court held that such clauses are not enforced to relieve contract parties of liability for their own negligence unless the clause clearly expresses an intent to relieve contract parties of liability for their own negligence. The defendant argued that management services are similar to professional services and cannot be subject to an implied warranty of workmanlike performance. The court held that a contract for management services implies that the management services be performed in a workmanlike manner. **Zenda Grain & Supply v. Farmland Indus., 894 P.2d 881 (Kan. App. 1995)**.

FEDERAL AGRICULTURAL PROGRAMS

CROP INSURANCE-*ALM* § 13.04.* The FCIC has issued interim regulations under the Small Grains, Coarse Grains, Cotton and Extra Long Staple Cotton crop provisions of the Common Crop Insurance regulations to allow insureds to collect both a guaranty deficiency payment under the 50/92 and 0/92 provisions of the wheat, feed grains, cotton and rice programs and a prevented planting indemnity under the crop insurance program. **60 Fed. Reg. 35832 (July 12, 1995)**.

The FCIC has adopted as final regulations providing additional sanctions, including fines and disqualification, for willfully and intentionally providing false or inaccurate information and for adoption of a material scheme or device to obtain insurance benefits. **60 Fed. Reg. 37323 (July 20, 1995)**.

FARM PROGRAMS. The ASCS and CCC have adopted as final regulations, under the feed grain, wheat, cotton, rice and related programs, implementing the changes made by the Agricultural Reconciliation Act of 1993 and to implement the Options Pilot Program and the Voluntary Production Limitation Program. **60 Fed. Reg. 33331 (June 28, 1994)**.

HERBICIDES. The plaintiffs were bean farmers who purchased the herbicides Prowl and Scepter manufactured by the defendant and applied the herbicides to their bean crops. The plaintiffs claimed to have purchased the herbicides based on advertisements made by the defendant and did not look at or rely on the labels of the herbicides. The plaintiff sued for breach of express and implied warranties of merchantability because the herbicides did not effectively control the weeds as claimed in the advertisements. The defendant argued that the suit was barred by pre-emption of FIFRA. The court held that the action was not barred by FIFRA because the action did not involve the labeling of the herbicides but only the advertising and promotion of the products, areas not covered by FIFRA. **Malone v. American Cyanamid Co., 649 N.E.2d 493 (Ill. Ct. App. 1995)**.

PEANUTS. The CCC has issued interim regulations to add the requirement that peanut producers comply with the crop insurance regulations of 7 C.F.R. Part 400 in order to qualify for the price support program. **60 Fed. Reg. 35834 (July 12, 1995)**.

PERISHABLE AGRICULTURAL COMMODITIES ACT-*ALM* § 10.05[2].* The Secretary of Agriculture has issued proposed regulations which provide for the adjudication of the issue of whether a person is "responsibly connected" with a commission merchant, dealer or broker in the same disciplinary proceedings against the commission merchant, dealer or broker. The proposed regulations also provide that the adjudication be made by an Administrative Law Judge. **60 Fed. Reg. 34474 (July 3, 1995)**.

SEEDS-*ALM* § 10.02.* The APHIS has adopted as final regulations to include in the definition of noxious weed seeds under the Federal Seed Act (FSA) all weeds listed in the Federal Noxious Weed Act (FNWA). The regulations are designed to overcome the prohibition of application of the FNWA to imported shipments of seeds subject to the FSA regulations. The problem was most recently adjudicated in *Pennington Seed, Inc. v. U.S., 10 F.3d 6 (D.C. Cir. 1993)* (destruction of imported grass seed containing serrated tussock seed improper because grass seed governed by FSA which did not list serrated tussock seed as noxious weed). **60 Fed. Reg. 35829 (July 12, 1995)**.

TUBERCULOSIS. The APHIS has issued an interim regulation changing Kansas from a modified accredited state to an accredited-free state. **60 Fed. Reg. 33100 (June 27, 1995)**.

WEEDS. The APHIS has adopted as final amendments to the noxious weed regulations to remove *Stratiotes aloides* Linnaeus (water aloe) and *Euphorbia prunifolia* Jacquin (painted euphobia) from the list of noxious weeds and to add *Ottelia alismoides* (L.) Pers and *Solanum viarum* Dunal (tropical soda apple) to the list. **60 Fed. Reg. 35831 (July 12, 1995)**.

FEDERAL ESTATE AND GIFT TAX

ADMINISTRATION EXPENSES. The decedent's estate included a 150 acre residential property which was included in a marital trust for the decedent and over which the decedent had a general power of appointment. If the decedent did not appoint the property to someone, the property passed to a residuary trust established by the decedent's predeceased spouse. The decedent did not appoint the property; however, the estate held the property until other assets were sold and until after the federal estate tax return was filed. The estate tax return included a deduction for the anticipated costs of maintaining and

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selling the property. The court held that the costs were not deductible because the estate gave no sufficient reason for holding the property so long and not transferring the property itself to the residuary trust where the costs would be chargeable to the trust. **Est. of Millikin v. Comm'r, T.C. Memo. 1995-288**.

CHARITABLE DEDUCTION. The decedent's will provided for the estate property to pass to an inter vivos trust for the care and maintenance of the decedent's pet cats and dogs, with the remainder to pass to charitable organizations. The trustees split the trust into a trust with sufficient property to provide for the animals and a second trust with charitable organizations as the only beneficiaries. At the death of the last animal, the remainder of the first trust passed to the charitable trust. The IRS ruled that the second trust was eligible for the charitable deduction but that the first trust was not. **Ltr. Rul. 9526027, April 5, 1995**.

DISCLAIMERS-*ALM* § 5.02[6].* The decedent's will bequeathed the residuary estate to a trust for the decedent's two children. The trust was to be divided into two portions with one portion to equal the decedent's generation skipping transfer tax exemption amount. One child disclaimed a testamentary power over the GSTT trust property, a power to change the GSTT trust trustee and the power to serve as trustee of the GSTT trust. The IRS ruled that the disclaimer was effective. **Ltr. Rul. 9526019, March 31, 1995**.

GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].* The taxpayer established three charitable lead annuity trusts prior to 1984 with the taxpayer's issue as remainder holders who would receive interests in trust in the trusts' property. Two of the trusts had terminated as to the charitable annuity interests and the third trust was about to terminate. The taxpayer and remainder holders merged the three trusts, retaining the separate provisions of the trusts to the extent that the trusts provided different rights for the remainder beneficiaries. The IRS ruled that the merger would not subject the trusts to GSTT. **Ltr. Rul. 9525057, March 28, 1995**.

Seven trust were originally established from 1963 through 1969, each with three of the grantor's children as remainder holders and a charitable organization as income beneficiary. The trusts obtained a state court order to divide the trusts into three trusts, one for each child. The IRS ruled that the division would not subject the trusts to GSTT. **Ltr. Rul. 9524026, March 22, 1995**.

The decedent's will established three trusts in 1962, one for the surviving spouse and one for each of the couple's two children and their spouse's and issue. The spouse had died and the trustee discovered that the trust contained no provision for distribution or cumulation of trust income between the time the spouse died and the termination of the spouse's trust. The trustee applied for a state court construction of the will to determine the disposition of trust income for the spousal trust. The IRS ruled that the state court construction would not subject the trusts to GSTT. **Ltr. Rul. 9524027, March 22, 1995**.

LIFE INSURANCE. The decedent had owned a Federal Employees Group Life Insurance policy and had made an irrevocable assignment all ownership of the policy. the court held that the proceeds of the policy were includible in the decedent's gross estate because the policy and law prohibited the irrevocable assignment of the right to designate a beneficiary; thus, leaving the decedent with a possibility of regaining an aspect of ownership. **Hays v. Comm'r, 95-2 U.S. Tax Cas. (CCH) ¶ 60,203 (S.D. Ill. 1995)**.

SPECIAL USE VALUATION-*ALM* § 5.03[2].* The decedent's will bequeathed ranch property to several qualified heirs. On the estate's federal estate tax return, the box for the special use valuation election was checked and much of the filing requirements for the election were met with the exception of (1) the recapture agreement; (2) the information supporting the special use values claimed; (3) the name, address, taxpayer identification number and relationship to the decedent of all persons having an interest in the property; (4) written appraisals of the property; (5) the value of the property received by each heir; and (6) affidavits concerning material participation by heirs. The return also failed to include the signature of all heirs on the Notice of Election. The IRS notified the estate of the missing requirements and the estate supplied the missing elements within 90 days; however, the IRS denied the special use valuation election because the initial election did not substantially meet the requirements. The Tax Court held that the election did substantially meet the requirements for the election. The appellate court reversed. The court focused on the lack of the recapture agreement and held that no special use election substantially complies with the election requirements if it does not include a recapture agreement; therefore, the estate's special use valuation election could not be perfected. **Est. of Hudgins v. Comm'r, 95-2 U.S. Tax Cas. (CCH) ¶ 60,202 (5th Cir. 1995)**.

TRANSFERS WITH RETAINED INTERESTS-*ALM* § 5.02[3].* The decedent had reached a property settlement agreement with the decedent's former spouse which created a trust for the decedent with the remainder passing to the former spouse in trust. The property settlement was included in the divorce decree. The IRS ruled that because the former spouse had no marital rights in the property transferred to the trust, the decedent did not receive any consideration for the property transferred to the trust and the property was included in the decedent's gross estate. The IRS also ruled that, because the decedent was deemed to have received consideration for the transfer to a spouse under I.R.C. § 2043(b)(2), the decedent's estate could deduct the value of the interests in trust transferred to the former spouse. **Ltr. Rul. 9527007, March 22, 1995**.

VALUATION. The taxpayer established two trusts, identical except that one trust was for four years and the other for seven years. The trusts were funded with S corporation stock. The trusts provided for an annuity of an increasing percentage of the value of the trust to be paid first from trust income and second from trust principal, with any excess income to be accumulated in principal. If the taxpayer died before the termination of the trusts, the trusts' property passed as appointed by the taxpayer or to the taxpayer's estate; otherwise, the property passed to named individuals. The IRS ruled that the taxpayer was considered the owner of the trusts and that the trusts were QSSTs. The IRS also ruled that the taxpayer's annuity interests were qualified annuity interests and the value of the gifts to the remainder holders was the fair market value of the assets transferred to the trusts less the value of the annuity interests retained by the taxpayer. **Ltr. Rul. 9525032, March 22, 1995**.

FEDERAL INCOME TAXATION

BUSINESS EXPENSES. The taxpayer was a business manager and shareholder in an S corporation which operated a car dealership. The taxpayer entered into an agreement with the corporation to pay bonuses to the corporation for any losses incurred by the corporation. The purpose of the agreement was to provide an incentive for the taxpayer to effectively manage the corporation's business. The court held that the payments were deductible as an ordinary and necessary business expense incurred to protect the business. **DeLorean v. Comm'r, T.C. Memo. 1995-287**.

C CORPORATIONS-*ALM* § 7.02.*

CONSTRUCTIVE DIVIDENDS. The taxpayers, husband and wife, were the sole shareholders in a corporation. The taxpayers made withdrawals from the corporation in several years and treated the withdrawals as loans for federal income tax purposes. During the years involved, the corporation declared few if any dividends even though the corporation had substantial earnings and profits. The corporation did not pass a resolution authorizing the loans, the loans had no note or other agreement for repayment and the taxpayers provided no security for the loans. The court held that the loans were taxable as constructive dividends. **Epps v. Comm'r, T.C. Memo. 1995-297**.

COOPERATIVES-*ALM* § 14.03.* The taxpayer was a taxable farmers' cooperative which issued annual dividends in part by qualified written notices of allocation of the cooperative's taxable profit. The cooperative's patrons included the amounts in the notices in their taxable income. When a patron terminated a membership, the cooperative redeemed the notices held by the patron at a discounted amount. The IRS argued that, under the tax benefit rule, the difference between the face value of the notices and the amounts actually paid to terminated patrons was taxable income to the cooperative. The court acknowledged that the cooperative tax laws were based on a "one level" taxation, either at the cooperative level or at the patron level and that the patrons were deemed to have constructively received the amounts in the written notices of allocation. However, the court agreed with the IRS that the discounting of the redemption amount carried back that amount to increase the original taxable income; therefore, the tax benefit rule applied to include the discounted amount in the cooperative's taxable income. **Gold Kist, Inc. v. Comm'r, 104 T.C. No. 34 (1995)**.

DEDUCTIONS. The IRS has adopted as final regulations eliminating the rule that required an employer to deduct and withhold income tax as a prerequisite for claiming a deduction for property transferred to an employee in connection with the performance of services. The proposed regulations provide guidance for substantiating a deduction for transfers of property for services. **60 Fed. Reg. 36995 (July 19, 1995)**.

DEPLETION-*ALM* § 4.03[5].* The taxpayer was a corporation which owned timber in Oregon and California. The taxpayer combined the timber tracts into one unit for purposes of claiming depletion, although 94 percent of the harvested timber came from the Oregon land. The IRS denied much of the deduction because the IRS separated the land into two tracts and calculated depletion separately for each tract. The IRS argued that its decision was not judicially reviewable because the decision was an interpretation of the regulations. The court held that the application of a regulation to the taxpayer's case was a judicial function performed by the IRS and was subject to judicial review. The IRS also argued that Treas. Reg. § 1.611-3(d)(5) empowered the IRS to readjust depletion allowances. The court held that the regulation was invalid because it exceeded the IRS authority to promulgate regulations since the regulation gave the IRS a judicial authority. **RLC Industries Co. v. Comm'r, 95-2 U.S. Tax Cas. (CCH) ¶ 50,328 (9th Cir. 1995), *aff'g*, 98 T.C. 457 (1993)**.

DUES DEDUCTION. The IRS has adopted as final regulations disallowing the dues deduction for dues paid to luncheon clubs, airline and hotel clubs and any organization which has the principal purpose of conducting entertainment activities or gaining access for the members to entertainment facilities. The regulations would allow the deduction for service club dues. The regulations reflect the changes made by OBRA 1993. **60 Fed. Reg. 36993 (July 19, 1995), *amending* Treas. Reg. § 1.274-2**.

HOBBY LOSSES. The taxpayers were not allowed investment tax credit, depreciation or other expenses exceeding the income from a cattle farm because they did not operate the business with the intent to make a profit since the taxpayers did not have sufficient experience, did not consult with experts, did not keep adequate records and did not spend much time at the business. Appellate decision designated as not for publication. **Lombard v. Comm'r, 95-2 U.S. Tax Cas. (CCH) ¶ 50,350 (4th Cir. 1995), *aff'g*, T.C. Memo. 1994-154**.

LIKE-KIND EXCHANGES-*ALM* § 4.02[16].* The taxpayers owned timber land and entered into a contract with a corporation which allowed the corporation to cut all trees on the property during the two year length of the contract. The corporation transferred three tracts of timber land to the taxpayers in exchange for the trees cut. The corporation finished cutting all the trees about 75 days after entering into the agreement. The IRS cited two cases with similar facts but different conclusions. In *Commissioner v. Crichton, 122 F.2d 181 (5th Cir. 1941), aff'g, 42 B.T.A. 490 (1940)* like-kind exchange treatment was allowed for the exchange of a royalty interest in a mineral estate for a city lot. In *Fleming v. Comm'r, 24 T.C. 818 (1955), aff'd 356 U.S. 260 (1958)* like-kind exchange treatment was not allowed for an assignment of some oil payment rights in exchange for a fee interest in real estate. The IRS cited *Koch v. Comm'r, 71 T.C. 54 (1978)* for the explanation that the difference between the holdings was that the royalty interest continued until the mineral was exhausted and the oil payment right could terminate before the mineral was exhausted. In the current case, the IRS ruled that like-kind exchange treatment (nonrecognition of gain and loss) was not allowed because the corporation was allowed only two years to cut the trees, allowing the possibility that not all

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trees would be cut. The IRS characterized the exchange as trees for land. The IRS did not discuss the fact that all the trees were actually cut within the two year period, implying that the availability of like-kind exchange treatment depends on the language of the agreement and not the actual conduct of the parties. **Ltr. Rul. 9525002, Feb. 23, 1995**.

The taxpayer, a trust, owned an undivided interest in several parcels in one tract of land with several other persons. All owners agreed to an exchange of interests so that each co-owner would receive a complete fee interest in a portion of the land equal to the value of the original undivided interest in the whole parcel. The exchange was made through a qualified intermediary who received title to the property and then simultaneously reconveyed title to each portion to each person. The taxpayer held the property for investment before and after the exchange and all property was of like-kind. The IRS ruled that the exchange qualified for nonrecognition of gain. The IRS cautioned that because the other owners were related to the taxpayer, I.R.C. § 1031(f) could cause recognition of gain from the exchange if the property is sold by the taxpayer or a related party within two years after the exchange. **Ltr. Rul. 9525038, March 22, 1995; Ltr. Rul. 9525039, March 22, 1995**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

INADVERTENT TERMINATION. A shareholder of an S corporation died leaving shares of the corporation's stock to two trusts which were QSSTs. However, neither trust filed an election to be treated as a QSST and the corporation did not distribute the trusts' share of income to the trusts but paid the funds to the IRS as estimated taxes for the benefit of the trusts' beneficiaries. When the errors were discovered, the trusts' beneficiaries requested permission to file the elections retroactively and to amend their personal tax returns to show the additional corporation income which should have passed to the trusts. The IRS ruled that the termination was inadvertent and that the corporation could continue to be taxed as an S corporation if the beneficiaries filed a proper QSST election and amended their tax returns. **Ltr. Rul. 9527018, April 6, 1995**.

SHAREHOLDER'S INTEREST. The IRS has issued proposed regulations governing the determination of a shareholder's pro rata share of S corporation items of income, loss, deduction and credit. Under the proposed regulations, each shareholder's pro rata share of an item is determined by assigning an equal portion of each item to each day of the corporation's taxable year, unless an election is made to terminate the taxable year because of termination of a shareholder's interest. **Prop. Treas. Reg. § 1.1377-1(a)(1)**. For this purpose, an S corporation's taxable year does not include any day in which the corporation did not have any shareholders. **Prop. Treas. Reg. § 1.1377-1(a)(2)(i)**. If a shareholder transfers all stock or dies, the shareholder is treated as a shareholder on the day of the transfer or death. **Prop. Treas. Reg. § 1.1377-1(a)(2)(ii)**.

If a shareholder's entire interest in the corporation is terminated, the remaining shareholders can unanimously elect to apply the above rules as if the corporation tax year was split into two taxable years. **Prop. Treas. Reg. § 1.1377-1(b)**. A terminated shareholder's interest in the corporation as an owner of an option to purchase stock, creditor, employee, director or other non-shareholder capacity is disregarded. The election does not otherwise affect the S corporation's taxable year or filing date.

The election takes precedence over the election provided by Treas. Reg. § 1.1368-1(g)(2) but is not allowed if the S corporation election is terminated. **Prop. Treas. Reg. § 1.1377-1(b)**.

The proposed regulations also defines "post-termination transition period" as (1) the period beginning on the day after the last day of the taxable year as an S corporation and ending on the later of one year later or the due date of the return for the last taxable year and (2) 120 days after a determination that the S corporation election had terminated. **Prop. Treas. Reg. § 1.1377-2**. **60 Fed. Reg. 35882 (July 12, 1995)**.

SALE OF RESIDENCE. The taxpayer sold a residence and purchased a new residence when the taxpayer was over 55 years old. The taxpayer's tax return preparer made the I.R.C. § 121 election to exclude the gain from the sale of the residence. Several years later, the taxpayer sold the second residence and purchased a third and claimed the Section 121 election again. The IRS denied the second election because only one Section 121 election is allowed each taxpayer. The taxpayer argued that the first election was an error and sought revocation of the election on the grounds the sale and reinvestment provisions of I.R.C. § 1034 were mandatory and would have covered the gain involved. The court held that the election could not be revoked more than three years after it was made and could not be revoked because of reliance on the tax return preparer. Appellate decision designated as not for publication. **Robarts v. Comm'r, 95-2 U.S. Tax Cas. (CCH) ¶ 50351 (11th Cir. 1995), *aff'g*, 103 T.C. 72 (1994).**

SECURED TRANSACTIONS

AGISTER'S LIEN. The plaintiff had successfully defended against an action by a secured creditor for a deficiency on a loan after the sale of the collateral livestock. The deficiency was barred by the failure of the creditor to give to the plaintiff proper notice of the sale of the collateral. The plaintiff brought the present action to recover the costs of caring for the livestock during the previous action, arguing that the plaintiff had a statutory agister's lien for the costs of caring for the livestock. The court held that the remedy of barring any deficiency was sufficient compensation to the plaintiff for the misconduct of the creditor and that to provide an additional award would amount to a double recovery. The court also refused to extend the agister's lien law to allow the owner of livestock to attach a lien for the costs of caring for that livestock. **Coones v. F.D.I.C., 894 P.2d 613 (Wyo. 1995)**. See also **Coones v. F.D.I.C., 848 P.2d 783 (Wyo. 1993)**.

CITATION UPDATES

International Paper Co v. U.S., 33 Fed. Cl. 384 (1995) (interest) see p. 93 *supra*.

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STATE REGULATION OF AGRICULTURE

WAREHOUSES. The defendants were an employee of a Colorado grain storage corporation, the Colorado corporation and a California corporation which owned 90 percent of the Colorado corporation. The plaintiffs were bean producers who had stored beans with the Colorado corporation. The plaintiffs accused the defendant of negligence, fraud, and violation of the Colorado Farm Products Act, Colo. Rev. Stat. § 12-16-101 et seq. for the sale of the plaintiffs' beans without permission and the covering up of the transaction with sham trades between the corporations. The California corporation denied any liability for the actions of the Colorado corporation's employee. The court held that the employee was acting as an agent of the Colorado corporation because the employee's actions were within the scope of employment and the employee personally arranged the transactions which gave rise to the fraudulent sales. The California corporation also argued that it was not liable for the actions of the Colorado corporation under the alter ego doctrine. The court held that because the Colorado corporation was formed by the California corporation and 90 percent financed and controlled by the California corporation, the California corporation was liable for the actions of the Colorado corporation and its agents. The defendants also argued that the Farm Products Act did not provide a private right of action to enforce the Act. The court held that the Act did provide a private right of action if the offended producer first obtained the prior written consent of the Commissioner of Agriculture, which the plaintiffs did. **Gorsich v. Double B Trading Co., Inc., 893 P.2d 1357 (Colo. Ct. App. 1994)**.

SEEDS. The plaintiff was a corporation which purchased cantaloupe seeds from the defendants. The plaintiff sent the seeds to a grower in Panama who grew the seeds under a contract with the plaintiff. The plaintiff claimed that the seeds were defective and sued the defendants for breach of express and implied warranties of merchantability and for breach of implied warranty for a particular purpose. The defendant argued that the action was barred by Fla. Stat. § 578.26 which required a "farmer" to first bring an administrative action with the Florida Seed Investigation and Conciliation Council for resolution before bringing any court action. The plaintiff argued that it was not a "farmer" under the act because it did not grow the seeds. The court held that the plaintiff was a farmer and was barred from the action for failure to first bring an administrative action. The court found that the plaintiff produced the melons through the contract with the Panama grower for sale by the plaintiff. **Interlatin Supply v. S & M Farm Supply, Inc., 654 So.2d 254 (Fla. Ct. App. 1995)**.

ISSUE INDEX